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Skadden, Arps, Slate, Meagher & Flom LLP
& Affiliates

June 20, 2014

Fee-Shifting Bylaws: The Current State of Play

If you have any questions regarding the matters discussed in this memorandum, please contact the following attorneys or call your regular Skadden contact.

Peter Allan Atkins
New York
212.735.3700
peter.atkins@skadden.com

Edward P. Welch
Wilmington
302.651.3060
edward.welch@skadden.com

Stephen F. Arcano
New York
212.735.3542
stephen.arcano@skadden.com

Allison L. Land
Wilmington
302.651.3180
allison.land@skadden.com

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One Rodney Square, 920 N. King Street
Wilmington, Delaware 19801
Telephone: 302.651.3000

Four Times Square, New York, NY 10036
Telephone: 212.735.3000

WWW.SKADDEN.COM

As previously reported, on May 8, 2014, the Delaware Supreme Court issued an opinion in *ATP Tour, Inc. v. Deutscher Tennis Bund (German Tennis Federation)*, No. 534,2013 (Del. May 8, 2014), holding that fee-shifting provisions among parties in intra-corporate litigation in a Delaware non-stock corporation's bylaws are not *per se* invalid. This decision prompted the suggestion from a number of sources that stock corporations, including public companies, adopt fee-shifting bylaws that would require all litigation expenses of the defendant corporation (and perhaps other defendants in their corporate capacities) to be paid by the plaintiff stockholder(s) who sued unsuccessfully.

The Proposed Legislation

In response to the *ATP Tour* decision, the Delaware State Bar Association proposed Senate Bill 236, which, if adopted by the legislature, would have limited applicability of the *ATP Tour* decision to non-stock corporations and made clear that fee-shifting bylaws, or other charter or bylaw provisions, may not impose monetary liability on stockholders of stock corporations. The expressed goal of the proposed legislation was to make clear that a corporation cannot undermine the limited liability protection of stockholders underlying Delaware corporation law.

Like the Supreme Court's decision in *ATP Tour*, Senate Bill 236 became the subject of much attention and debate from the media and legal commentators and prompted a significant amount of lobbying efforts. The U.S. Chamber Institute for Legal Reform (an affiliate of the U.S. Chamber of Commerce), for example, urged the Delaware General Assembly not to adopt Senate Bill 236, noting that the unanimous *ATP Tour* decision gives corporations a means to protect their stockholders against the high costs of litigation by deterring the filing of abusive, duplicative suits.

Other commentators believed that Senate Bill 236's prohibition was too broad, eliminating the opportunity to design well-tailored fee-shifting provisions that adequately balance the interests of corporations and their stockholders, and that other market protections (including activist investors and proxy advisory firms) serve as a sufficient deterrent to adoption of overly protective fee-shifting bylaws by publicly traded corporations. Some commentators felt that additional time was necessary to study the effect of fee-shifting bylaws and analyze the appropriate legislative response, if any.

The Reaction and Delaware Legislative Response

On June 18, 2014, Senate Bill 236 was withdrawn, and the Delaware Senate adopted Senate Joint Resolution No. 12, which addresses the issue of fee-shifting bylaws. The Senate Joint Resolution has been submitted to the House of Representatives and is expected to be considered by it promptly.

The Senate Joint Resolution recognizes the need to maintain balance, efficiency, fairness and predictability in protecting the legitimate interests of all stakeholders, and to ensure that the laws do not encourage meritless litigation or impose unnecessary costs on Delaware entities to their detriment. It also recognizes the abusive nature of meritless and duplicative multi-jurisdiction litigation, while recognizing the chilling effect of deterring meritorious litigation that could be an unintended consequence if stock corporations were to adopt fee-shifting bylaws.

Given the "complexity and importance" of the issues addressed by fee-shifting bylaws, the Senate Joint Resolution urges the Delaware State Bar Association, and its Corporation Law Section and Council, to continue its ongoing examination of the permissible scope of provisions of the certificate of incorporation, bylaws and other similar business entity documents affecting the conduct of and the forum for litigation involving claims arising under Delaware's business entity laws as well as the laws involving appraisal rights. The Senate Joint Resolution also calls upon such examination to consider whether legislation addressing such matters would be appropriate for submission to the General Assembly in 2015.

What To Do

For the reasons set forth below, stock corporations should carefully consider the potential consequences that could result from adoption of a non-stockholder approved fee-shifting bylaw.

Although the legislation has been withdrawn in 2014, as a legislative matter in Delaware it is far from over. If legislation is proposed in 2015, it could prohibit all fee-shifting bylaws, rending invalid any such bylaws that previously had been approved, or could create parameters on the adoption of such bylaws that are not yet anticipated.

More importantly, for Delaware and non-Delaware public companies, there is a significant risk that adoption of fee-shifting bylaws by boards of directors of those companies could generate a meaningful adverse reaction from, among others, governance advocates, proxy advisory firms and some stockholders. This could result in, among other things, stockholder proposals to repeal board-adopted fee-shifting bylaws and/or "vote no" campaigns against some or all directors who supported adoption of the offending bylaw (with particular focus on the members of the governance committee of the board). The reaction could be similar to that produced when some public companies adopted bylaws that imposed restrictions on dissident director nominees receiving compensation from stockholders proposing them — most were rescinded in relatively short time frames due to pressure from a range of constituencies opposing the bylaws.

In light of these risks and, for Delaware corporations, the Senate's direction to the Delaware State Bar Association to continue studying legislation on the topic, we believe companies should proceed with caution in this area.

For companies wishing to give consideration currently to adoption of a fee-shifting bylaw, matters to consider, in consultation with appropriate advisors, include:

- For non-Delaware companies, whether there is legal precedent for proceeding (including looking to Delaware precedent);
- The company's stockholder profile;
- The state of the company's (and board's) relationship with its stockholder base;
- The right of the board and stockholders to amend the bylaws;
- The terms of any proposed fee-shifting bylaw;
- Whether the bylaw should be adopted by the board, the board with a condition subsequent of stockholder ratification, or by stockholders in the first instance;

- The timing of adoption;
- The views expressed by relevant constituencies regarding the subject of fee-shifting bylaws;
- The potential/likely reactions of those relevant constituencies to the bylaw action contemplated;
- The ability to rescind a fee-shifting bylaw or to submit it to stockholder ratification in response to constituency reactions;
- The approaches taken by and experiences of other companies; and
- The possibility, nature and timing of a legislative response.

A Related Measure: Forum Selection Provisions

As a separate means of reducing the litigation burden on public companies, we continue to believe that public companies should consider adoption of an exclusive forum charter or bylaw provision requiring all stockholder derivative suits, fiduciary duty claims and other intra-corporate actions to be brought in the courts of the state in which the company is incorporated. Adoption of such a provision is motivated largely by the desire to reduce the burden and significant expense of multi-jurisdictional stockholder litigation, in which stockholder lawsuits are brought against the corporation and its board of directors in multiple jurisdictions on behalf of the same class of stockholders. In 2013, the Delaware Court of Chancery ruled that exclusive forum provisions in director-enacted bylaws are valid and enforceable under Delaware law. Since that ruling, exclusive forum provisions are becoming a common tool for Delaware companies to reduce the cost and risk of multi-jurisdictional stockholder litigation.